

Updated December 1, 2017

California Cap-and-Trade Program

Guidance on Treatment of Unsold Allowances Following an Undersubscribed Auction

Allowances issued under the California Cap-and-Trade Program and the Québec Cap-and-Trade System are offered for sale in Joint Auctions conducted by California and Québec. These allowances include California state-owned and Québec provincial-owned allowances, California allowances consigned by electrical distribution utilities and natural gas suppliers (consigning entities), and California allowances required to be sold at auction for reasons described in the California Cap-and-Trade Regulation (California Regulation).¹ Starting with the February 2018 Joint Auction, allowances issued under Ontario's Cap-and-Trade Program will be offered for sale as well.

If an auction is undersubscribed, where not all allowances offered for sale are sold, the three jurisdictions' regulations specify how those unsold allowances are managed and offered at subsequent auctions. This document describes the requirements for the California state-owned and consigned allowances. For purposes of this document, "California allowances" refers to all allowances designated to auction from California sources, including consignment sources and the California Air Resources Board (CARB). "California state-owned allowances" refers to CARB allowances held in the Auction Holding Account that are not from consignment sources. "Consigned allowances" refers to allowances consigned to auction from utilities, natural gas suppliers, and other sources as described in the California Regulation.

A. Sources of Allowances to Fulfill Bids

How does CARB award allowances for successful bids in the Current Auction?

If the quantity of bids accepted by the Auction Administrator² equals or exceeds the number of allowances offered for sale in the Current Auction, then all the offered allowances will be sold.

If the quantity of bids accepted by the Auction Administrator is less than the number of allowances offered for sale in the Current Auction, for the allowances offered for sale by

¹ California allowances that may be required to be sold at auction can include allowances from closed Compliance Instrument Tracking System Service (CITSS) accounts, allowances from accounts that contain allowances in excess of the holding limit, allowances from suspended or revoked accounts, allowances submitted for untimely surrender obligations, and allowances that were originally freely allocated and have been returned as a result of an enforcement settlement.

² Bids accepted by the Auction Administrator are referred to in the Joint Auction Notices and Joint Auction Summary Results Reports as "qualified" bids.

California, winning bids will be fulfilled with allowances from sources in the following order (pursuant to section 95911(f) of the California Regulation):

- i. Allowances consigned to auction from closed accounts, accounts containing allowances in excess of the holding limit, or accounts suspended or revoked, pursuant to section 95910(d)(2);
- ii. Allowances consigned from Limited Use Holding Accounts (LUHAs) pursuant to section 95910(d)(1);
- iii. Allowances designated by CARB that were unsold in prior auctions and are re-designated to the auction pursuant to section 95911(f)(3); and
- iv. Allowances designated by CARB for auction.

Unsold California state-owned and consigned allowances are held in the Auction Holding Account for sale at subsequent auctions. Section B describes the handling of unsold consigned allowances and Section C describes the handling of unsold California state-owned allowances.

B. Consigned Allowances in an Undersubscribed Auction

In each quarterly auction, consigning entities consign allowances that have been allocated to their LUHA to be sold in the Current Auction.

When an auction is undersubscribed, what happens to the consigned allowances that remain unsold?

Pursuant to section 95911(f)(4), allowances consigned to auction from LUHAs and those consigned pursuant to section 95921(g)(3) that remain unsold at auction will be held in the Auction Holding Account and offered in the next auction. If those allowances remain unsold at the next auction, they will continue to remain in the Auction Holding Account and will be offered for sale in each subsequent auction until sold.

If the total number of winning bids is less than the total number of allowances from consignment sources, how will CARB determine the amount to award from each consigning entity?

Winning bids will be filled first with allowances consigned to auction from closed accounts, accounts containing allowances in excess of the holding limit, and accounts that have been suspended or revoked. After all of these allowances from consignment sources are awarded, the remainder of the winning bids will be fulfilled with allowances consigned from LUHAs. The quantity of allowances sold by each consigning entity will be determined as that entity's proportional share of the total allowances consigned from LUHAs.

The number of allowances sold by each entity is calculated as the entity's share of the total consigned allowances multiplied by the total number of consigned allowances sold, rounded down to the nearest whole allowance. If there are remaining consigned

allowances to fulfill winning bids, a random number is assigned to each consigning entity and beginning with the lowest random number, an allowance sale is assigned to each entity until all remaining consigned allowances are used to fulfill winning bids.

When will each consigning entity be informed of the total consigned allowances sold by that entity in the auction?

Each entity receives a Consigned Allowances Statement from the Financial Services Administrator no later than the day prior to distribution of auction proceeds.

What happens to unsold allowances consigned from LUHAs at the end of the calendar year?

Any allowances consigned from LUHAs that remain unsold at the end of the calendar year will be offered in the Current Auction of the first auction of the next calendar year. In this case, the Current Auction will include allowances from multiple vintages. Please refer to the [Multiple Vintage Allowances Offered in the Current Auction FAQ](#) available on the CARB Cap-and-Trade Program webpage for more information. If any of those allowances continue to remain unsold, they will remain in the Auction Holding Account and will continue to be offered at each subsequent auction until sold.

When fulfilling winning bids in an auction, do allowances that were consigned from LUHAs in a prior auction and were not sold have priority over newly consigned allowances?

All allowances consigned from LUHAs have the same priority in fulfilling winning bids in an auction, whether they were consigned and unsold in a prior auction or were consigned to that auction.

Must allowances be consigned to the auction if some of the allowances previously consigned remain unsold?

Each calendar year, a consigning entity must offer for sale at auction all allowances that have been placed in its LUHA that correspond to the current calendar year. It is at each consigning entity's discretion to choose when within the calendar year to consign its allowances. The fact that consigned allowances may remain unsold from prior auctions does not alter these requirements. Please refer to the [Guidance for Allowance Consignment to Auction](#) available on the CARB Auction Information webpage for more information.

C. Returning Unsold California State-Owned Allowances to Auction

California state-owned allowances that remain unsold from an undersubscribed Current Auction are eligible to return to auction after two consecutive Current Auctions have resulted in a settlement price above the Auction Reserve Price. However, the return is not automatic. Section 95911(f)(3)(C) of the California Regulation specifies that the

maximum number of unsold allowances that can be returned is 25 percent of the California allowances offered at that auction. Any unsold allowances above that amount remain in the Auction Holding Account. If the allowances have remained unsold for more than 24 months, they are placed into either the Allowance Price Containment Reserve pursuant to section 95911(g), or retired pursuant to section 95852(b)(1)(D) of the California Regulation.

Joint auctions in February 2016, May 2016, August 2016, November 2016, and February 2017 were undersubscribed. This has resulted in California retaining a total of 104,704,896 unsold California state-owned allowances in its Auction Holding Account as of the date of this guidance document.³

How is the 25 percent limit applied?

The following scenario illustrates how the 25 percent limit was applied in the November 2017 Joint Auction. All of the numbers shown in this real-life scenario are publicly available through CARB's Cap-and-Trade website.

The February 2016 Joint Auction offered a total of 71,555,287 current vintage allowances for sale. A total of 2,951,275 current vintage California state-owned allowances and 578,552 current vintage Québec provincial-owned allowances remained unsold. The May 2016 Joint Auction offered a total of 67,675,951 current vintage allowances for sale. The undersubscription of the auction resulted in 35,610,823 current vintage California state-owned allowances and 9,031,647 current vintage Québec provincial-owned allowances remaining unsold.⁴

The first time these previously unsold allowances became eligible for being re-offered for sale was the November 2017 Joint Auction, because the May 2017 and August 2017 Joint Auctions were the first two consecutive auctions to settle above the Auction Reserve Price. Table 1 presents the number of current vintage allowances designated to the November 2017 Joint Auction. As shown in the table, 54,962,497 California allowances were offered, which included both California state-owned and consigned allowances. Applying the 25 percent figure, the maximum number of unsold California-state owned allowances that could be re-designated to this auction was 13,740,624 (25 percent of 54,962,497).

The Québec Cap-and-Trade Regulation uses the same 25 percent limit on the return of unsold Québec provincial-owned allowances. Under the Québec regulation, Québec re-designated 2,169,033 allowances (25 percent of the 8,676,132 allowances indicated in Table 1) that remained unsold from prior auctions. Ontario's regulation uses the same 25 percent limit as well.

³ This number reflects that 13,740,624 previously unsold allowances were sold at the November 2017 Joint Auction (see Table 1).

⁴ A total of 15,773,481 consigned allowances remained unsold at the May 2016 Joint Auction. Section B describes how unsold consigned allowances are managed and offered at subsequent auctions.

Since the quantity of unsold allowances from prior auctions exceeded the maximum allowable quantity as described above, Table 1 shows the total number of allowances that was actually offered for sale at the November 2017 Joint Auction. If the quantity of unsold allowances from prior auctions had been less than the maximum allowable quantity, all the unsold allowances would have been offered for sale at the auction.

Table 1: November 2017 Joint Current Auction With Returned Previously Unsold Allowances			
	California	Québec	Total
Allowances Designated for Auction	54,962,497	8,676,132	63,638,629
Previously Unsold State-Owned and Provincial-owned Allowances	13,740,624	2,169,033	15,909,657
Total Allowances to be Offered	68,703,121	10,845,165	79,548,286

What do the recently approved regulatory amendments related to unsold allowances at auction mean?

Previously, unsold California state-owned allowances that remain unsold from an undersubscribed Current Auction would have continued to be available and returned to auction after two consecutive Current Auctions resulted in a settlement price above the Auction Reserve Price, subject to the 25 percent limit.

On July 27, 2017, the Board approved amendments to the California Regulation that specify that beginning January 1, 2018, California state-owned current vintage allowances that remain unsold in the Auction Holding Account for more than 24 months will be transferred to the Reserve, unless they have been otherwise retired to compensate for Energy Imbalance Market (EIM) Outstanding Emissions pursuant to section 95852(b)(1)(D) of the California Regulation. This provision (section 95911(g)) requires CARB to remove allowances that remain unsold after two years from immediate availability and to supplement the Allowance Price Containment Reserve when there is a period of low demand.

By way of example, if the 2,951,275 vintage 2016 allowances that remained unsold at the February 2016 Joint Auction had remained unsold up through and after the February 2018 Joint Auction, those allowances would be either retired for EIM purposes or moved into the Allowance Price Containment Reserve. As indicated above, those allowances were ultimately re-designated to the November 2017 Joint Auction and they have been sold.

Could CARB decide to re-designate less than 25 percent?

CARB will not re-designate less than 25 percent if the number of unsold allowances equals or exceeds 25 percent. Section 95911(f)(3) states that unsold allowances will be designated to the auction subsequent to two consecutive auctions that have an auction settlement price above the Auction Reserve Price, subject only to the 25 percent limit. Once unsold allowances can be re-designated to an auction, if previously unsold

allowances remain in the Auction Holding Account due to the 25 percent limit, they will be offered in subsequent auctions until sold or until they remain unsold for more than 24 months (in which case, they would be treated pursuant to section 95911(g) of the California Regulation).

What happens if previously unsold allowances are re-designated to an auction and that auction is undersubscribed?

If an auction at which previously unsold allowances are re-designated and offered for sale is undersubscribed, there may be allowances left from previous auctions that continue to remain unsold. This would depend on the exact nature of the undersubscription and the order in which bids are fulfilled (see above for the regulatory order of filling successful bids), among other factors. If previously unsold state-owned allowances were re-designated and offered for sale, but still remain unsold, these allowances are still subject to the regulatory requirements wherein they cannot be re-designated to auction until another two consecutive auctions settle above the Auction Reserve Price, subject to the 25 percent limitation in section 95911(f)(3) and the 24-month limitation in section 95911(g).

What if unsold allowances remain from multiple undersubscribed auctions?

The 25 percent figure applies to all unsold California state-owned allowances, whether they remained unsold at a single auction or multiple auctions. For instance, the total quantity of unsold California state-owned allowances that could be re-designated to the Current Auction in November 2017 was at most 13,740,624. Previously unsold California state-owned allowances greatly exceeded this amount, so California re-designated exactly 13,740,624 allowances from the allowances that remained unsold at the February 2016 and May 2016 Joint Auctions.

How are future vintage California state-owned allowances that remain unsold at auction treated?

Future vintage allowances that remain unsold at an Advance Auction are treated in a similar manner to current vintage allowances during the same calendar year in which they were unsold. If two consecutive Advance Auctions settle above the Auction Reserve Price in the same calendar year in which those future vintage allowances were first designated to auction, then unsold future vintage allowances would be re-designated to the Advance Auction up to the 25 percent limit specified in section 95911(f)(3). However, if future vintage allowances remain unsold at the end of the calendar year for which they were designated for sale at Advance Auction, they will remain in the Auction Holding Account until their vintage year. They will then be designated for the Current Auction pursuant to section 95910(c)(1)(B) of the California Regulation.

For example, unsold allowances from an Advance Auction in February could be re-designated to the November Advance Auction (up to the 25 percent figure) if both the

May and August Advance Auctions that immediately follow settled above the Auction Reserve Price. However, because there are only four auctions each calendar year, unsold allowances from Advance Auctions in May, August, or November would remain in the Auction Holding Account until their vintage year in all cases.

Where can I find additional information?

For additional information on the Cap-and-Trade Program, please visit the Cap-and-Trade website at <https://www.arb.ca.gov/cc/capandtrade/capandtrade.htm>.

For additional information on joint GHG allowance auctions, please visit the Auction Information website at <https://www.arb.ca.gov/auction>.